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No. 94-1183

In the Supreme Court of the United States

OCTOBER TERM, 1994

NORAM ENERGY CORP.,
Petitioner,

v.

THE UNITED STATES,
Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

PETITIONER'S REPLY MEMORANDUM

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ARGUMENT

The Respondent submits essentially two erroneous arguments in support of its contention that the appeals court properly applied the doctrine of collateral estoppel to bar the Petitioner from litigating the purely legal question presented in this case. Each of these arguments will be addressed in turn.

I. The Effect of *Montana* on the Continuing Validity of the *Sunnen* "Separable Facts" Analysis

First, the Respondent contends that collateral estoppel applies here because the parties, facts, legal issues and legal principles which were before the Federal Circuit in this case are

identical to those which were before the Fifth Circuit in *Arkla, Inc. v. United States*, 765 F.2d 487 (5th Cir. 1985), *cert. denied*, 475 U.S. 1064 (1986) ("*Arkla I*"). The Respondent dismisses as irrelevant the fact that *Arkla I* involved an asset placed in service in 1980, whereas this case involves physically-distinct, but functionally-equivalent, assets placed in service the following year. The Respondent thus rejects the continued viability of the "separable facts" analysis originally laid down by this Court in *Comm'r v. Sunnen*, 333 U.S. 591, 68 S.Ct. 715, 92 L.Ed.2d 898 (1948), and instead reads *Sunnen* and its sequel, *Limbach v. Hooven & Allison Co.*, 466 U.S. 353, 104 S.Ct. 1837, 80 L.Ed.2d 356 (1984), as standing for the proposition that only an intervening change in the law will prevent the application of collateral estoppel in the tax setting. The Respondent relies upon this Court's holding in *Montana v. United States*, 440 U.S. 147, 59 L.Ed.2d 210, 99 S.Ct. 970 (1979), in support of this contention, arguing that this later case tempered the original *Sunnen* analysis.

The Petitioner first would note that this case in fact poses such an intervening change in the law as the Respondent contends is necessary to preclude the application of collateral estoppel (see the discussion in Part II, below.) Moreover, and without regard to the existence of an intervening change in the law, the Petitioner construes the *Hooven* decision as a reaffirmation of the original *Sunnen* analysis regarding the narrow application of collateral estoppel in tax cases. This conclusion also may be found in the writings of several noted commentators who have expressed the view that the issues of fairness which pervade tax litigation present a strong case for continued adherence to the *Sunnen* rule. These commentators argue that, as long as separable facts are involved, relitigation should be permitted even with respect to identical issues of law application.[1]

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[1]See, *e.g.*, Griswold, *Res Judicata in Federal Tax Cases*, 46 Yale L.J. 1320 (1937); Wright, Miller & Cooper, *Federal Practice and Procedure: Jurisdiction* §4425.

The arguments presented on both sides of this issue highlight the confusion which now surrounds the application of collateral estoppel in tax cases This uncertainty regarding the proper application of a legal principle by which one's very right to litigate a tax controversy will either live or die behooves this Court to grant a Writ of Certiorari in this case and clarify this issue which is of significance to all taxpayers and taxing jurisdictions.

II. Whether the Application of Collateral Estoppel in this Case Would Result in the Inequitable Administration of the Revenue Laws

The Respondent also contends that the application of collateral estoppel in this case will not result in the sort of injustice of which the Petitioner complains, arguing that there will be no disparity in the treatment of taxpayers within the Federal Circuit because the Court of Claims reached the same result in *Transwestern Pipeline Co. v. United States*, 639 F.2d 679, 225 Cl. Ct. 999 (1980), as did the Fifth Circuit in *Arkla I*. Specifically, the Respondent argues that "[i]n *Transwestern*, the taxpayer was allowed to depreciate only the *non*recoverable portion of its line pack gas; it was not permitted to depreciate its recoverable gas." (Opp. p.7). The Respondent thus argues that this case does not present the pivotal issue raised by Justice White in *United States v. Stauffer Chemical Co.*, 464 U.S. 165, 104 S.Ct. 575, 78 L.Ed.2d. 388 (1984), but which has yet to be addressed by the majority of this Court; *i.e.*, whether a taxpayer who raises an issue of law within any particular circuit is entitled to be treated the same as all other taxpayers who raise the same issue within that circuit.

The Respondent's argument rests upon a misstatement of the *Transwestern* holding. Although the *Transwestern* court and the Fifth Circuit in *Arkla I* may have reached the same *result* under prior law, their *analyses* could not have been more inconsistent, as revealed by a subsequent change in the law. The *Transwestern* court concluded that the economically-recoverable volume of line pack gas constitutes the salvage value of the gas as a whole and,

under the prior law depreciation scheme, reduced the *amount* of the depreciation deductions to reflect the existence of this salvage value. The Fifth Circuit in *Arkla I*, on the other hand, concluded that the economically-recoverable and nonrecoverable volumes of cushion gas represent entirely separate and distinct assets. Because salvage value was a critical component in determining the allowance for depreciation with respect to any asset placed in service before 1981, either of these analyses would have led to the same result regarding the amount of depreciation deductions available in any action brought under prior law. The new provision of the law under which this action was brought, however, changed the depreciation scheme with respect to assets placed in service after 1980 by eliminating salvage value as a factor in determining the amount of allowable depreciation deductions. Thus, while the economically-recoverable volumes of the Petitioner's line pack and cushion gas would be eligible for depreciation under the *Transwestern* salvage value analysis, they would not be depreciable under the *Arkla I* separate asset analysis.[2] It is this change in the law which presents the very potential for the unequal administration of the revenue laws with which Justice White was concerned. Accordingly, this case presents this Court with the opportunity to resolve precisely the issue raised by Justice White's concurrence in *Stauffer Chemical*.

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[2]The *Transwestern* court clearly equated the economically-recoverable line pack gas with the salvage value of the line pack as a whole:

. . . it must be noted that the plaintiff depreciated the entire cost of the line pack on the theory that it would be wholly lost and would have no *salvage value* at the end of the pipeline system's useful life. The evidence in this record shows that, on the contrary, it reasonably appeared at the time when the line pack was injected into the plaintiff's pipeline system that the line pack would have some minor *salvage value* at the end of the system's useful life. . . . A "jury verdict" to the effect that the line pack should be regarded as recoverable and *salvageable* to the extent of 12 percent would seem to be appropriate for present purposes, and this is included in the findings of fact. 639 F.2d 679, 688.

The foundation for Justice White's analysis best reveals the nature of the Federal Circuit's fundamental error in this case. Justice White reasoned, in general, that relitigation of an issue should be permitted if the issue is one of law and a new determination is warranted to implement an intervening change in the law or to avoid the inequitable administration of the law. This conclusion was founded upon the notion that, because the law is dynamic, the doctrine of collateral estoppel should be applied in a manner so as to ensure litigants only the benefit of prior *litigation*, as opposed to the benefit of a prior *ruling*. Accordingly, Justice White emphasized that the doctrine does not apply to preclude relitigation of a pure issue of law, noting that "the distinction is between an abstract legal proposition and the application of that proposition to particular facts."[3] Thus, while collateral estoppel furthers the interest of ensuring reliance on adjudicated matters by protecting a judgment once rendered from later being attacked by the losing party in another case, the doctrine does not preclude the unsuccessful litigant from later challenging the validity of the rule laid down in the first case as an abstract proposition of law. Collateral estoppel thus historically has not been applied to burden the losing party with an erroneous rule of law in any subsequent action between the same parties.[4] This is so because it would be manifestly unjust to forever apply the erroneous rule of law as to the once unsuccessful litigant, yet to apply the correct rule to any person not bound by the earlier judgment.

It would be equally unjust to preclude the Petitioner from litigating in the Federal Circuit the purely legal question posed in this case. First, all of the relevant facts in this case were

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[3]See Justice White's concurring opinion in *Stauffer Chemical*, 464 U.S. at 181, n.2. This Court has long held that the doctrine of collateral estoppel does not apply to pure questions of law. See, *e.g.*, *United States v. Moser*, 266 U.S. 236 at 241, 69 L.Ed. 262, 45 S.Ct. 66 (1924); and Scott, *Collateral Estoppel By Judgment*, 56 Harv.L.Rev. 1, 7 (1942). See also Wright, Miller & Cooper, *supra*, n. 1.

[4]Scott, *supra*, n. 3.

stipulated, and the matter was submitted to the United States Court of Federal Claims for decision on cross motions for summary judgment. The case thus involves no question of fact, but is limited to a theoretical construction of the relevant provisions of the Internal Revenue Code as construed in the light of Congressional intent. In particular, this case involves the abstract legal question of whether the economically-recoverable portion, element, or value which an asset may have upon its abandonment or other disposition should be treated as the salvage value of that asset (under the *Transwestern* analysis) or as an entirely separate and distinct asset (under the *Arkla I* analysis) for purposes of determining whether it constitutes "property of a character subject to the allowance for depreciation" within the meaning of Section 168 of the Internal Revenue Code. The greatest irony which stems from the Federal Circuit's holding in this case is found in the fact that the Petitioner would not have been collaterally estopped from again arguing this question of law even before the Fifth Circuit, which decided *Arkla I*. How, then, can the Federal Circuit purport to deny the Petitioner the right to relief under its own jurisprudence? This alone illustrates the inherent inequity which would result should the Federal Circuit's holding be allowed to stand.

CONCLUSION

The arguments submitted by the Petitioner and the Respondent concerning whether this Court should grant a Writ of Certiorari in this case attest to the confusion which abounds on the part of both the courts and the bar concerning the proper application of collateral estoppel in tax cases. In light of the definitive nature of the collateral estoppel doctrine in terms of the rights of litigants, this Court must grant a Writ of Certiorari to eliminate the prevailing uncertainty.

Further, this case presents precisely the issue posed by Justice White's concurrence in *Stauffer Chemical*, but which the majority of this Court has yet to address. This case thus presents the Court with the opportunity to resolve this issue and provide the

much-needed guidance concerning the proper role of collateral estoppel in the tax context. Accordingly, the Petition for a Writ of Certiorari should be granted.

Respectfully submitted,

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